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Credit - Tool or Trap?

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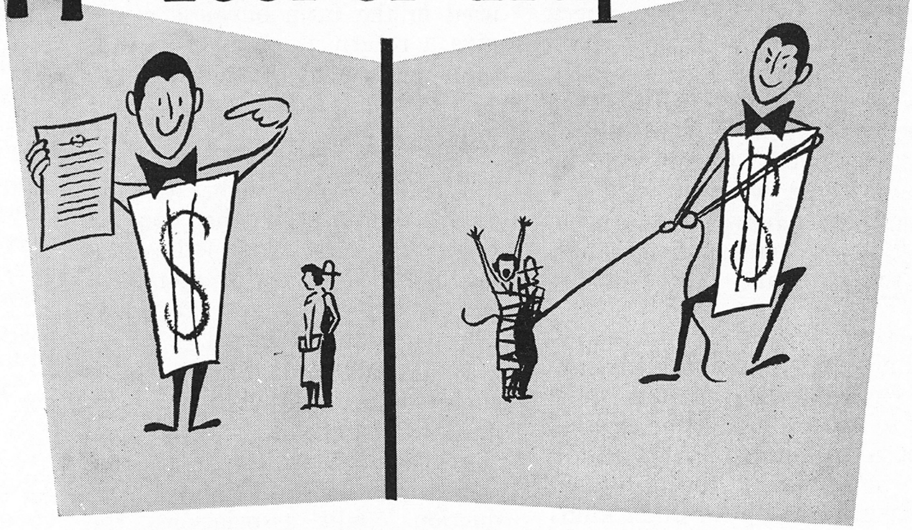


by Gordon E. Bivens and Margaret I. Liston

YOUR attitudes toward credit probably affect how you buy, what you buy and when you buy. Use of credit may come natural to you—the charge account at the store, the "deferred" dental bill or cattle loan. Or, for various reasons you may be wary of credit.

Is it a tool, or is it a trap? When does it stop being one and become the other? Used rationally it can be a tool and contribute to family security. Used thoughtlessly it can be a trap contributing to insecurity. Farm families can use credit both for the farm business and for family living. Let's take a closer look at consumer credit and production credit and their relationships to family living.

Used More . . .

More and more farm families find it necessary to borrow money now and then—for farm operating expenses, for family living or both. Investments in equipment and the day-to-day out-of-pocket expenses for both the farm and home have increased.

Household cash outlays—for home equipment and furnishings as well as for operating expenses—have risen. We buy things now that were unknown or "out of reach" a few years ago. And we now pay for services which we once did for ourselves.

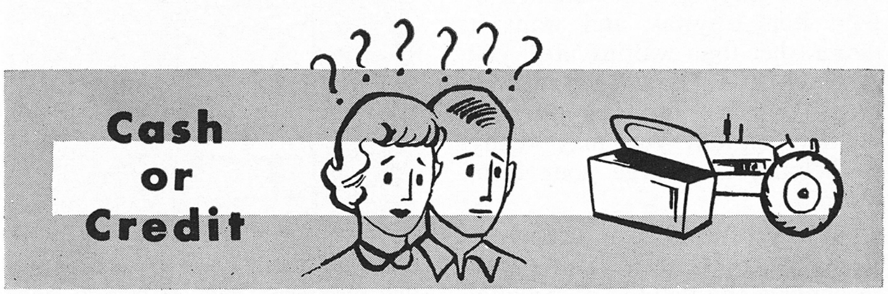
On the business side, too, capital investment and the "cash kitty" needed to cover a year's operating expenses are sizeable. Changes in farm practices and the substitution of machinery for labor have led to greater out-of-pocket costs.

From both sides, it adds up to greater reliance on money as a means of getting the things we consider necessary for family living and farm operation. And, because most families are limited in the amount of money they have, credit offers one way to gain the use of added capital.

The "Answer"?

Credit may be the answer in some cases and contribute to greater income and family financial security. In others, it may be a threat to a family's financial well being. Most logically, credit would be used as a resource or tool just as you'd use any other resource—your time, managerial ability, the capital you own and the land you farm.

Production credit—capital borrowed for use in your farm business—can help to get a better balance among your other resources. By adding to the total amount of capital you have, credit may allow you: (1) to make bet-



Farm families often face decisions on how to use their cash or credit resources—a home freezer for family living, for example, or a tractor for the farm business? Another decision is whether to use cash or credit or a combination. Also, should purchase be made now or later?

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ter use of your managerial ability through managing a larger volume of business; (2) to make better use of your machinery through having additional land on which to operate the machinery you now have; or (3) to make better use of your labor if it's not fully employed. Credit can be used in these ways to strike a better balance between your basic resources of management, labor, land and capital.

Consumer credit for things used in family living (automatic washers, freezers and the like) may help to achieve the same general purpose—a better balance among your resources by "substitution" of consumer credit for other kinds of capital. Sometimes only the family's own capital or perhaps a portion of a cash loan for production purposes is used for family living items. This "drains off" some of the capital which may be needed for production purposes.

If consumer credit is readily available—as is commonly true—consider the possibility of using it for some of the family living items to protect your own capital and production credit for farm operation purposes. This doesn't mean to use consumer credit indiscriminately. Use it with caution and the assurance that items bought fit into family over-all plans.

Remember: Whether you borrow for production *or* consumption purposes, you assume that your future income will repay the loan. Unwise use of credit could mean that your level of living might outstrip your future ability to pay off.

On the other hand, you may be "set" on buying a certain household item anyway and want it *now* rather than waiting until you can pay cash. By using consumer credit and not draining off production capital, you may really be helping to enlarge your farm income.

This substitution of consumer for production credit is one way to achieve the volume of production needed to more nearly provide your family with the income it wants. But consumer credit isn't without costs. So you'd want to be reasonably sure that the additional money which could be used in the farm business would give a return as great or greater than the cost of consumer credit.

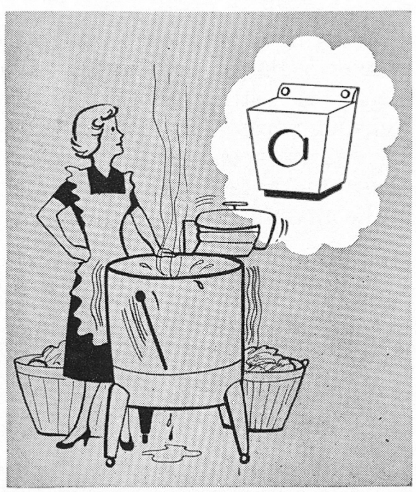
Getting Credit . . .

Whether you ought to use credit, as well as whether you *can* get it, is affected by (1) the lending agencies to which you have access and (2) your capacity, character and collateral.

Banks are probably the most common source of credit for farm production purposes and, in some areas, for consumer goods, too. Other possibilities include production credit associations, the Farmers Home Administration, small loan companies, merchants or dealers and individuals.

When you apply for credit, the lender wants to know, for example, how your past and prospective incomes reflect your *capacity* to pay your obligations. Have you established yourself as one of good *character* who is conscientious about meeting your obligations? What property or *collateral* do you have as security?

These are not separate. Your capacity to repay is affected by your character and by what you have to work with. Your collateral is affected by your capacity in previous years and by your character as reflected by the ways you've used your income.



Consumer credit offers a means of getting something "now" instead of waiting until cash is available. But the convenience and satisfaction from the "now" should be balanced against the cost (interest) of getting the credit.

When Does It Pay?

Broadly speaking the capital needed for operating the farm and for family living expenses can come either from (1) savings or your *own* capital—an excess of income over expenses in an earlier period—or (2) *borrowed* capital from credit sources. When borrowing, what guides can be used in borrowing and using these funds?

For family living: It's easier to set down credit guideposts for the farm business side than the family living side. The reason: We can use prospective profits as a yardstick for the farm business. No such impersonal yardstick is available when we consider using money for household items and family living. We can't always measure the returns in dollars and cents. It's more difficult to agree on whether to buy this or that or on how important any one item is.

One guide might be that it "pays" to use consumer credit for goods such as food freezers, home furnishings or TV—if your family gets enough satisfaction from having these things *now* and if you're willing and able to pay the interest on the money rather than waiting until you can pay cash. Having labor-saving equipment, for example, may be important to a young family where the mother's time is needed for children or for outside chores and fieldwork. Or, it may be important to take a trip while the children are still at home. To estimate the satisfactions of having things "now" calls for knowing your family goals. What *is* most important to your family?

It's also important to know how much interest you're paying for consumer credit—to shop around and compare the direct and indirect costs of credit.

Remember that interest rates can be quoted in different ways. Often the *actual* rate of interest is much higher than the charges seem to indicate. Be sure to compare the actual annual rates of interest you'd be paying if you borrowed from different lenders—

banks, personal loan companies, installment contracts.

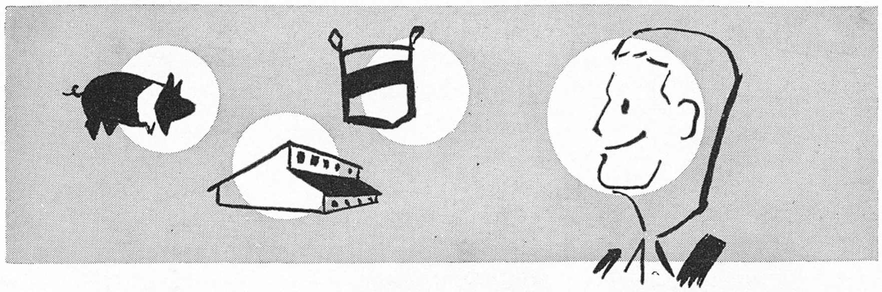
Another point: The interest rate at the bank or other lender is not necessarily the one to use in considering the costs of having certain conveniences now. Why? You might be able to take the same money—say $300—and use it for fertilizer or some other farm expense. If you did and realized, say, $100 profit on the $300, you'd be getting a 33-percent return. This would be the most meaningful figure for comparison since you have the opportunity or alternative of using the $300 for the farm business as well as for the household.

For farm operation: It "pays" to use credit in the farm business any time that the use of more money in the business returns more than enough to repay the loan plus interest. The main factor here is uncertainty. You're never sure what yield you'll have when you plant a crop. You're seldom certain what the price will be when you sell your products—except for those which have a support price announced before planting or seed crops grown on a per-acre contract.

There's also a question of *where* to use credit in the farm business—for fertilizer, more livestock, machinery, labor, what?

Part of the answer depends on how long it takes to get the money back. That is, how long will it take for the investment to "ripen"? It takes longer to get the money back if it's put into machinery or buildings, for example, than in hogs or fertilizer. This is important to many families. How important depends on the particular situation.

Another question is how far to go in using additional capital for a particular purpose. With plenty of capital, you could simply keep on using more money in each phase of your farm business—hog production, fertilizer, machinery, etc.—until the cost of using an additional dollar would no longer be covered by the return from using it. If it cost you $5 for every $100 borrowed, you'd come out ahead on each $100 invested that returned more than $5 over the $100 invested.



Production credit can be used for a number of purposes—livestock, fertilizer, buildings, etc. But where it's used can make a lot of difference both in the size of the returns and in the timing of them.

Usually, however, capital is limited, often quite limited, and the guide is different. Instead of investing additional money in all phases that returned a profit, the need here is to find the phase or phases that return the *most* per dollar invested.

If you find, for example, that $100 invested in one phase can be expected to boost profits $7 and in another phase only $5, the one with $7 would have first call on that $100. But if another $100 used in the phase which boosted profits $7 for the first $100 gave a boost of only $3 for the second $100, then the enterprise returning $5 over costs would have first call on the second $100.

With limited capital, a fast "turnover" is usually desired. With plenty of capital, you need not be so much aware of the different alternatives for investment as you do when capital is limited. With plenty available, you can afford to invest it wherever it returns more than the investment. But with limited capital, you'll always be better off investing in the alternatives giving the *highest* returns per dollar invested.

So here is your guide for limited capital: Look for all possible alternatives for what capital—owned or borrowed—you have. Don't use the money in a way that will return you less than it would if invested somewhere else. This could mean spreading your capital around to get the most out of it.

Tool, Trap or "Handy"?

We've been talking about some of the guideposts or principles for the most effective use of credit. We've tried to show that decisions to use credit or not—and, if so, for what purposes—are more important than you may have thought to the success of farm operations and family living.

We've also indicated that credit can be a trap if you use it unwisely or go "overboard." It can also be used in moderation as simply something "to get along with"—not going overboard, but without much thought going into it, and without much purpose being served by it. We've emphasized, however, that credit can be used as a tool for moving toward realization of your family goals.

Whether your use of credit is a trap, merely something handy to have around or a tool depends on the values you place on the things we've been talking about. For any family, it can be any one of the three.

Your "Neighbors" . . .

What things affect a family's decision about using credit? To what extent do farm people use credit for household goods, farm production or land? To find out, we've questioned a group of farm people in one Iowa county. Later on, we'll report on the results.

We'll take a look at the kinds of things for which consumption credit is being used and how often it's used. We'll look also at the kinds of things for which production credit is being used and at the sources of this credit. Mortgage credit will also enter the picture. How do husbands and wives differ as to ways they'd use additional money for household or production uses? We'll present more specific information on these in forthcoming issues of IOWA FARM SCIENCE.